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C O N F I D E N T I A L SECTION 01 OF 03 DHAKA 002749

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SENSITIVE

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DEPT PASS TO DOE, OPIC, EXIM, TDA  
MANILA FOR USADB

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SUBJECT: BANGLADESH UNVEILS ELECTION-FOCUSED FY 2006 BUDGET

Classified By: P/E Counselor D.C. McCullough, reason para 1.4 d.

[11.](#) (SBU) Summary: Finance Minister Saifur Rahman unveiled the FY 2006 (July 2005-June 2006) budget on June 10, generating controversy over extension of the "whitening of black money" provision and general concern that the budget is election focused and potentially inflationary with its strong emphasis on rural development and education. Overall assessment of the budget is mixed. End Summary.

[12.](#) (SBU) In his budget speech to Parliament, Rahman announced agricultural subsidies, soft loans for farmers, a large education allocation, and other populist measures in the last full budget before the next general election expected in January 2007. The budget also includes allowances for the mentally disabled, more student grants and help for long-term unemployed farmers as well as a series of tax exemptions for agro-based, leather and textile industries.

[13.](#) (SBU) The USD 10.7 billion budget is based on a revenue forecast of USD 7.4 billion and represents a 15.7 percent increase on current spending. Fifty-four percent of the revenue and development budget will go to direct and indirect poverty reduction programs. According to the finance minister, annual GDP growth is expected to exceed six percent in the next fiscal year. Tax exemptions and tax holidays, due to expire in July 2005, have been extended for three more years.

[14.](#) (SBU) Key points include:

-- Farm subsidies were doubled to USD 200 million (1200 crore taka) in an attempt to boost agricultural growth.

-- Education funds were allocated for 3 million female students from primary school to college level. Scholarship funds were allocated for 15,000 female college students, up from 9000 scholarships last year.

-- Safety net provisions were extended to include monthly allowances for the mentally disabled.

-- New allocation for local government to the level of "Gram Sharkar" - village government - but with no mechanism or accountability set up to handle these funds, a potential floodgate for patronage.

-- "Whitening" of black money provision was extended for one more year.

-- Provisions for seasonal employment for workers in areas hit by yearly monga (partial famine).

Controversy

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[15.](#) (SBU) The extension of the "whitening" provision has generated widespread criticism from analysts and business leaders, who say it rewards illicit money. This provision was introduced three years ago and was expected to be phased out this year. Rahman had repeatedly indicated that he would repeal this provision in the FY 2006 budget. In the past three years, Rahman predicted that significant amounts of black money would be "whitened" under this provision. However, only a small fraction of the predicted amount was actually recovered. Despite previous-year disappointments, Rahman remains optimistic that in FY 2006 the provision will be better utilized due to a strengthened banking system and reforms in the anti-money laundering laws.

[16.](#) (SBU) In a June 12 meeting with Ambassador, Rahman expressed satisfaction with the overall budget but acknowledged that the extension of the "black money" provision is controversial. He said that he finds the provision "morally reprehensible" but had to extend it due to concerns over financial stability in the market. He said that black money was being taken to foreign markets, causing instability in the rate of taka (local currency) and drying up foreign reserves. Fearing greater losses, he extended the

provision but imposed a new 7.5 percent tax on the "whitened" money.

#### Import Duties

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17. (SBU) The budget forecasts a 12 percent increase (to USD 1.5 billion) in FY 2006 import duties over FY 2005. The key areas of increase come from import duties on 40 items including iron ore, luxury cars, garment imports, fruit juices, mineral water, and various mechanical and electronic products. Supplementary duty has been increased to 35 percent from 25 percent on processed food imports and on all furniture imports. Notable reductions in import duties were made in salt imports, crude petroleum, CNG engines, and telephone equipment. Import duties were eliminated for raw materials servicing export-oriented sectors like agriculture and textiles.

#### Direct Taxes

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18. (SBU) Total revenue from direct taxes is projected to increase by 15 percent in FY 2006 compared to FY 2005 (to little over USD 1 billion). The level of tax exempt income will be raised from 100,000 taka to 120,000 taka. Corporate income tax rate has been increased to 40 percent from 37.5 percent. Given the current year shortfall in income tax revenue is estimated at over USD 500 million, the expected USD 1 billion revenue from income taxes might be a hard target to meet.

#### Value Added Tax

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19. (SBU) The budget forecasts a 16 percent increase (to little over USD 2 billion) in FY 2006 Value Added Tax revenue over FY 2005 numbers. This increase is expected, in part, due to some new taxed sectors. The most controversial of the new taxes is a 1200 taka (20 dollar) VAT on SIM cards, which is offset by a 1200 taka tax reduction for cell phone hand sets.

#### Private and public sector reactions mixed

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10. (SBU) Opposition Leader Sheikh Hasina denounced the budget as election focused and pro-corruption. She cited the extension of the black money provision as proof that the budget is designed to benefit select groups.

11. (C) Science and Technology Minister Moyeen Khan expressed disappointment at the 10 percent import duty applied to software and the 1200 VAT applied to SIM cards. Privately, Khan griped to us: "The finance minister does not know how to use a computer or a cell phone. He lives in the nineteenth century and does not realize the importance of IT." Khan added that he is tired of fighting for his ministry, which once again received no funding for programs.

12. (SBU) Local analysts stated that the development budget - increasing outlays by 20 percent to 4.5 billion dollars - is aimed at gaining popular support ahead of the elections but could fuel inflation above its current 7 percent. The Center for Policy Dialogue (CPD), a social think tank, termed the budget as one of "care, compromise and collusion." With a boost of 46.2 percent, public service received the highest increment in expenditure. The Metropolitan Chamber, the most prestigious chamber in Bangladesh, criticized the extension of the "whitening" provision, calling it a "great economic injustice." The Foreign Investors Chamber termed the increase in corporate tax to 40 percent from 37.5 percent a deterrent to investment.

#### Comment

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13. (C) This budget has increased focus on rural and human development and places education as the top priority. Although election-oriented, this budget seems to focus on long-term development and select export sectors. Agricultural subsidies, broadened safety net provisions, education grants, and local government funds are all intended to generate political support for the ruling BNP in the run up to the next election. However, implementing these development programs will remain a major challenge. In the past several budgets, no development program was fully completed. According to some estimates, 70 percent of last year's projects have not been implemented.

THOMAS